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November 17, 2000

The Honorable Vernon A. Williams, Secretary
Surface Transportation Board
1925 K Street, NW Suite 700
Washington, DC 20423-0001

Re: Ex Parte No. 582 (Sub No. 1), Major Rail Consolidation Procedures

Dear Secretary Williams:

Enclosed are an original and 25 copies of the Comments of the American Chemistry Council and American Plastics Council, including the accompanying verified statements of Edward G. Kammerer and Terry A. Park. Also enclosed is a 3 ½" diskette containing the comments and verified statements in WordPerfect 5.x for Windows.

Please stamp the additional copy with the date of receipt and return with our messenger.

Sincerely,

Scott N. Stone

200390

CMA-3
APC-3

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)
MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS OF THE
AMERICAN CHEMISTRY COUNCIL
AND THE
AMERICAN PLASTICS COUNCIL

The American Chemistry Council ("the Council")[1] and the American Plastics Council ("APC")[2] respectfully submit these joint comments in response to the revised merger rules ("the Proposed Rules") contained in the Board's Notice of Proposed Rulemaking served October 3, 2000 (the "NPR Decision") and published at 65 Fed. Reg. 58974 (October 3, 2000).

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[1] The American Chemistry Council represents the leading companies engaged in the business of chemistry. Council members apply the science of chemistry to make innovative products and services that make people's lives better, healthier and safer. The Council is committed to improved environmental, health and safety performance through Responsible Care®, common sense advocacy designed to address major public policy issues, and health and environmental research and product testing. The business of chemistry is a $435 billion a year enterprise and a key element of the nation's economy. It is the nations largest exporter, accounting for 10 cents out of every dollar in US exports. Chemistry companies invest more in research and development than any other business sector. The Council was prior to June 12, 2000 known as the Chemical Manufacturers Association ("CMA"). In order to maintain consistency in the designations of its filings, the Council will continue to use the abbreviation "CMA" through the conclusion of this proceeding.

[2] APC is a national trade association representing 26 of the nation's largest resin producers, including monomer and polymer production and distribution. Founded in 1988, APC works to make plastics preferred materials by demonstrating they are a responsible choice in a more environmentally conscious world.

Executive Summary

The Council and APC have become convinced that, in light of the extreme concentration of the North American rail industry and the serious anticompetitive dangers posed by further mergers or alliances, the Board's authority to approve US rail mergers should be replaced by the review of such mergers, as well as rail marketing alliances, by the United States Department of Justice, which has developed detailed guidelines and precedents for reviewing both mergers and alliances.

However, given the above circumstances, and in the absence of such a statutory transfer of jurisdiction, the Proposed Rules should be substantially strengthened. Although the Proposed Rules in general represent a positive change in direction, they do not set any objective standards for evaluating mergers, and omit entirely any scrutiny of proposed marketing alliances. Concrete guidelines should be adopted for evaluating mergers and ensuring that they do not have anticompetitive consequences. For example:

- The Proposed Rules state that merging railroads should keep "major gateways" open. But there is no good reason not to keep all existing gateways open, since, as the Board recognizes, inefficient gateways have been largely eliminated. Keeping gateways open permits connecting carriers to compete for a portion of the shipper's business, and thus furthers the pro-competitive intent of the Proposed Rules. To ensure that merging railroads do not close or disadvantage gateways that exist at the time of the merger, the merging carriers must be required to publish rates to/from any interchange point to or from which the railroad published a rate prior to the merger, or to or from which the railroad carried traffic under a contract. Such rates should be published in accordance with the market driven proportional rate proposal discussed below. In addition, if a merger is approved, the Board must maintain an ongoing enforcement proceeding to hear any shipper complaints that gateways have been closed or commercially disadvantaged by the imposition of higher rates than existed pre-merger.

- The Proposed Rules require that mergers create enhanced competition, but back off from suggestions at an earlier stage of the rulemaking that the Board's "bottleneck" rule be modified in the case of merging carriers to promote competition. In order to ensure that rival railroads have an opportunity to compete for a shipper's business for at least a portion of the route from origin to destination, the Board must require merging carriers to publish rates to/from any reasonable interchange point with another carrier, regardless of whether the shipper has obtained a contract or commitment from the connecting carrier regarding the portion of the movement beyond the interchange point.

- The Proposed Rules would give a green light to rail alliances not involving formal mergers, despite the potential anticompetitive consequences of such alliances. The Board should expand the scope of its rules to encompass review of such alliances and their potential anticompetitive effects, and should set out in detail its standards for approving applications under section 10706 for joint ratemaking authority.

- The Proposed Rules are silent on the issue of "acquisition premiums" – the question how merging railroads will be able to pay the price for their merger without burdening rail-captive shippers with higher rates. The rules should ensure that full consideration is given to the effect of the acquisition premium on the rate structure of the merged system, so that the merger does not threaten to burden shippers with higher costs or worse service.

- The Proposed Rules require that the merging railroads demonstrate how the merger will enhance competition, but do not specify the quantum of new competition that is required. In addition, under the proposed rules a merger could be found in the public interest if enhanced competition offset potential service problems or (arguably) competitive harms of the merger. At a minimum, the rules must carry forward existing law by requiring applicants to fully preserve through conditions all actual and potential rail competition that would be reduced in the absence of the conditions. In addition, when a balancing of benefits and harms is permitted, the merger rules should require a geographic and industry balance so that the enhanced competition benefits the same areas and industries that would likely suffer the harms.

- The Proposed Rules would require merger applicants to set out a contingency plan including "additional measures that the Board might take if the anticipated benefits fail to materialize in a timely manner," but the Council and APC are skeptical that merging carriers could suggest practicable measures that would remedy the types of serious failures recent mergers have brought. The only effective contingency remedies, which the Board should mandate, are across-the-board guarantees that rates will not increase and service will not deteriorate.

I. The Proposed Rules Should Protect All Gateways.

The Proposed Rules state that merging railroads should keep "major gateways" open (NPR Decision at 14-16). At the outset, basing merger rules upon such a subjective and undefined term as "major gateway" would only invite disputes. But there is no reason to become enmeshed in such disputes, because there is no good reason not to keep all existing gateways open. Closing gateways would not significantly contribute to efficiency because, as the Board recognizes, inefficient gateways have already largely been eliminated (id. at 15-16). Keeping gateways open permits connecting carriers to compete for a portion of the shipper's business, and thus furthers the pro-competitive intent of the Proposed Rules. Closing any gateway, given the reality of limited shipper choices at origin and destination,[3] amounts to an anticompetitive tying arrangement that would not be permitted in an industry subject to the antitrust laws.

The Council and APC propose, therefore, that merging railroads commit to keeping all gateways/interchange points open, so long as the railroad prior to the merger had published tariffs, or participated in contract movements, via those gateways or interchange points.

Moreover, keeping gateways open, to be meaningful, must deal with actions going beyond outright cancellation of tariffs or restrictions on routing or interchange choices. Railroads seldom publicly announce that they are closing gateways. Instead, they employ pricing strategies to direct traffic over their preferred routes. These strategies are discussed in the attached verified statement of Edward G. Kammerer.

The best solution to the gateway issue would be the "Access Condition" proposed in the previous Joint Comments submitted by the Council and APC on May 16, 2000 in response to the Board's Advance Notice of Proposed Rulemaking served March 31, 2000 (the "ANPR"). The Access Condition would entitle every captive shipper on future

[3] A 1999 survey by the American Chemistry Council showed that 63% of rail-served chemical production facilities in the United States are captive to one railroad.

merged systems to gain access to one competing carrier, which would chose whether to provide the service based upon whether doing so would produce a sufficient economic return. Offering a joint rate at a shipper-selected interchange point would be one method that access could be provided under the Access Condition, but it would be up to the shipper, the origin railroad and the connecting carrier to negotiate the precise method and terms of access (subject to best offer arbitration).

The Council and APC continue to believe that their Access Condition would be the best way to ensure that future mergers are not anticompetitive, and refer the Board and parties to their earlier comments, which are of record in this proceeding.[4] For the reasons stated in those comments, the Access Condition would be preferable to traditional regulatory solutions dependent upon maximum rate proceedings, because it would be based on actual competition rather than simulated competitive benchmarks such as the stand-alone rate test and the standards in the non-coal reasonableness guidelines. The Access Condition would be based on a competitive marketplace in which access would be permitted but not mandated so that competition would occur only where a competing carrier could efficiently and profitably compete for a movement or portion of a movement.

Indeed, it is only because the Board has not included the Access Condition in its Proposed Rules that the Council and APC have outlined alternative suggestions in these comments regarding preservation of gateways, bottleneck rates, service and rate guarantees, and the like.

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[4] Any party that has joined this proceeding since the publication of the NPR Decision and who would like to receive a copy of the previously filed comments can request a copy by calling or writing the undersigned counsel.

In the absence of the Access Condition, to ensure that merging railroads do not close or disadvantage gateways that exist at the time of the merger, the merging carriers should be required to publish rates to/from any interchange point to or from which the railroad published a rate prior to the merger, or to or from which the railroad carried traffic under a contract. Such rates should be required to be published in proportion to the distance between the origin and interchange point, as compared with the distance between the origin and the originating carrier's preferred long-haul interchange or destination point, after adjusting for costs at origin and destination. As explained in the attached Verified Statement of Mr. Kammerer, such a market-driven proportional rate condition would increase the ability of would-be connecting carriers to offer alternative joint rates, and the resulting competition would encourage innovation, efficiency, and customer service.

Other parties may argue that the proportional rate proposal outlined in Mr. Kammerer's statement bears some resemblance to the "DT&I conditions" that the Board and the ICC have chosen not to impose in recent mergers.[5] But times have changed drastically in the nearly 20 years since DT&I conditions were abandoned. The number of carriers and carrier routing combinations has dramatically decreased. Route structures have been rationalized and inefficient gateways have already largely been eliminated. Thus rather than perpetuating an almost infinite and highly inefficient maze of routings and combinations, imposition of similar conditions today would simply preserve a dwindling number of efficient routing choices. Moreover, imposition of such a

[5] The ICC decided to discontinue the use of "DT&I" conditions in Traffic Protective Conditions, 366 I.C.C. 112 (1982), aff'd in part, Detroit, Toledo & Ironton R.R. v. United States, 725 F.2d 47 (6th Cir. 1984).

condition would be consistent with the Board's announced shift in focus from attempting to assist the rationalization of an inefficient and financially troubled rail industry to ensuring the preservation and enhancement of competition in the face of mergers that can no longer be justified on the basis of system rationalization. It is also worth noting, as Mr. Kammerer points out, that the proportional rate proposal is less intrusive that other means of enabling an alternative or connecting carrier to compete for a portion of the movement.

The Board's authority to require the publication of proportional rates is crystal clear. In creating the Board, Congress specifically retained the following provisions of Title 49, section 10701 of the US Code:

> (a) A through route established by a rail carrier must be reasonable. Divisions of joint rates by rail carriers must be made without unreasonable discrimination against a participating carrier and must be reasonable.
>
> (b) A rail carrier providing transportation subject to the jurisdiction of the Board under this part may not discriminate in its rates against a connecting line of another rail carrier ... or unreasonably discriminate against that line in the distribution of traffic that is not routed specifically by the shipper.

Certainly one reasonable way to interpret and implement these statutory provisions would be to require merging carriers to publish proportional rates in the manner suggested by Mr. Kammerer. Thus, if the Board continues to be unwilling to adopt the Access Condition proposed by the Council and APC, it should adopt the market-driven proportional rate proposal outlined in Mr. Kammerer's statement.

The above policy regarding gateways should apply to international gateways and interchanges. In addition, as detailed in the attached Verified Statement of Terry A. Park, the Board should affirm that shippers of international traffic should have all rights regarding interchange, interswitching and competitive access that they now have under Canadian (or Mexican) law.

The Board should also maintain an ongoing enforcement proceeding following future mergers to hear any shipper complaints that gateways have been closed or commercially disadvantaged. In order that merging carriers are not penalized for offering rates over new single system routings that may be lower than former joint rates for the same or competing routes, a shipper should not have the right to argue that a gateway has been commercially disadvantaged merely because such a new, lower rate has been offered.

II. The Bottleneck Rule Should Be Changed in the Case of Merged Systems.

One of the most positive suggestions contained in the Board's ANPR was that in the case of merged systems the bottleneck rule should be modified so as to permit the challenge of bottleneck rates regardless of whether the shipper had a signed contract in hand from a connecting carrier. In a stroke, that change would cut through the chief impediment to increased rail to rail competition today – the tacit agreement of the major railroads that they will not attempt to "poach" on each other's exclusive territories by agreeing to serve shippers on routings involving bottleneck segments. In the face of this behavior, the ability to challenge bottleneck rates under the Board's bottleneck rule is nonexistent.

Rather than requiring railroads applying for a merger to proffer some undefined quantum of enhanced competition, the Board should take the initiative and say clearly that if carriers want to merge, they must offer reasonable rates to interchange points. The

Board has clear authority to do so derived from section 10701(a) and (b) of Title 49, quoted above, and from carrier's common carrier obligation to provide rates and service upon request.

III. The Merger Rules Should Deal With the Acquisition Premium Issue.

The Proposed Rules do not deal with the issue of how merging railroads can achieve a return on the tremendous sums they pay for acquiring each other without increasing rates on captive traffic. It is meaningless to say that in principle a merger enhances competition if shippers have to pay higher rates to finance the huge windfall to shareholders lucky enough to have owned stock in the acquired railroad.

This is not a theoretical issue. In the Conrail split-up transaction, both NS and CSX incurred unprecedented debt loads to finance their purchase of Conrail at a premium of $3.9 billion over Conrail's market valuation before NS and CSX began their bidding war. True to the predictions of the Council that Conrail would not be able to achieve the levels of new traffic needed to pay off that debt without raising rates,[6] and that the transaction would cause service problems, neither NS nor CSX has achieved the new traffic they projected (especially the new intermodal traffic that was supposed to "remove trucks from I-95"), and both carriers have subsequently resorted to rate increases.[7]

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[6] Joint Comments of the Chemical Manufacturers Association and The Society of the Plastics Industry, Inc. ("CMA-10") filed October 21, 1997 in Fin. Dkt. No. 33388, CSX Corp. and CSX Transportation Inc., Norfolk Southern Corp. and Norfolk Southern Railway Co. – Control and Operating Leases/Agreements – Conrail, Inc. and Consolidated Rail Corp., at pages 6-16.

[7] See, e.g., "Railroads Put New Hauling Fees on Track," Wall Street Journal, February 9, 2000, page A3.

The analysis the Board should undertake of the "premium" issue is conceptually straightforward. How will the merged system pay off any debt incurred in the merger transaction? Will the increased costs of the merger be paid off with increased efficiencies? If so, how and over what time period? Will increased traffic enable the debt to be paid off? Again, how and over what time period? Merging carriers in the future should face a heavy burden of persuasion on these issues. The Board has already said it doubts future mergers will generate large efficiencies (NPR Decision at 10). Hence, it is doubtful large debts can be repaid through greater efficiency. Likewise, the Board is entitled to be very skeptical of promises of increased traffic – witness the failure of the Conrail split-up to take trucks off I-95, and the rather startling after-the-fact admission of Norfolk Southern's former chief of intermodal traffic, Thomas Finkbiner, that "It's very difficult to make money east of the Mississippi" on intermodal.[8]

The consistent pattern of the past several mergers has been that service has been disrupted and costs have gone up for both railroads and shippers. For example, the latest issue of Rail Business reports that service on both the NS and CSX portions of the former Conrail has reached a plateau with transit times well above those achieved by Conrail pre-merger. This record of failure justifies imposing a heavy burden requiring the railroads to show clearly and convincingly how the costs of their merger transaction will be paid without harming shippers. Captive shippers have borne the financial burden of failed mergers for too long. The Board must take a hard look at the recovery of acquisition premiums in any future mergers.

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[8] Traffic World, November 6, 2000, page 37.

IV. The Board Should Scrutinize Joint Marketing Agreements and Alliances.

The Board's Proposed Rules announce a policy of favoring marketing alliances over mergers, in that merger applicants must show why what they want to achieve in a merger cannot be accomplished in a marketing alliance. At the same time, the Board signaled during the CN-IC merger that it did not feel it needed to review the terms of joint marketing agreements.[9] Yet antitrust enforcement experts plainly recognize that marketing alliance can have anticompetitive effects, depending on factors such as the duration of the alliance, its involvement in pricing and asset allocation issues, and its exclusivity. The Department of Justice and Federal Trade Commission have published guidelines for assessing marketing alliances which spell out these factors and give detailed examples.[10] These guidelines are premised on the fact that "in some cases, competitor collaborations have competitive effects identical to those that would arise if the participants merged in whole or in part."[11]

So long as the Board, rather than the Department of Justice, continues to have authority to review mergers, the Board should announce that it will also review proposed joint marketing agreements and alliances, using the same guidelines employed by DOJ and the FTC. The Board should also clarify to what extent marketing alliances must

[9] Fin. Dkt. 33556, Canadian National Railway Co., Grand Trunk Corp., and Grand Trunk Western Railroad Inc. – Control – Illinois Central Corp., Illinois Central Railroad Co., Chicago, Central and Pacific Railroad Co., and Cedar River Railroad Co., Dec. No. 37 served May 25, 1999, at fn. 73 and accompanying text.
[10] Federal Trade Commission and US Department of Justice, "Antitrust Guideline for Collaborations Among Competitors" (April 2000). The Guidelines may be downloaded from the FTC website at http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf.
[11] Id., sec. 1.3.

apply for joint rate authority under section 10706, and what the standards will be for the Board's review and approval of such applications.

V. The Board Should Require Geographic and Industry Balance When Merger-Related Harms Are Offset By Enhanced Competition or Other Benefits.

The Proposed Rules suggest that a future merger might be approved, notwithstanding a conclusion that the merger will probably cause competitive harm or service disruptions, so long as the merger also proposes some undefined quantum of "enhanced" competition. The Proposed Rules appear to suggest that the enhanced competition need not be directed to the same shipper groups, industries or geographic areas that suffer the harm from the merger. For example, the Board states that "it is increasingly difficult to remedy certain competitive harms directly and proportionately" and that the plan for enhanced competition submitted by merger applicants "need not be directed to remedying specific competitive or other harms that are threatened by the merger." (NPR Decision at 13.)

Read literally, this portion of the proposed rules could be taken to mean that merger applicants no longer have to do the bare minimum that has been required of merger applicants heretofore – preserving all competitive options that would otherwise be lost to particular shippers if a merger is approved without conditions. With due respect, this portion of the Board's Proposed Rules, if read to eliminate the current rule that all specific competitive harms resulting from a merger are to be remedied, represents a sharp step backwards and is contrary to the Board's expressed intention to give future mergers stricter scrutiny.

Short of the Access Condition proposed previously by the Council and APC,[12] no "plan for enhancing competition" would effectively ensure that all shippers, industries and geographic areas that would otherwise be harmed by a proposed merger are made whole, unless the Board is prepared to require merging carriers to accept liability for money damages if their merger results in service problems or higher rates. But at a minimum, the Board should (1) clarify that it is not retreating from the longstanding insistence that there be a full, direct and proportional condition adopted by the merging carriers to remedy each and every competitive harm that would be created by a merger in the absence of conditions and (2) require that any "plan for enhancing competition" be accompanied by a study showing that the benefits of the pro-competitive plan outweigh the possible harms that would be caused by the merger both in the aggregate and in the case of each shipper group, industry and geographic area that would potentially be harmed by the merger.

VI. Proposed Contingent Remedies in the Event Benefits Fail to Materialize Must Have Real Teeth.

The Proposed Rules would require merger applicants to set out a contingency plan including "additional measures that the Board might take if the anticipated benefits fail to materialize in a timely manner." (NPR Decision at 14.)

The Council and APC are skeptical that merging carriers could always suggest practicable measure that would remedy the types of serious failures that the past two

[12] See the Joint Comments of the Chemical Manufacturers Association and the American Plastics Council (CMA-2/APC-2) filed May 16, 2000 in response to the Board's ANPR.

mergers, at least, have brought. Notwithstanding the Emergency Service Order ("ESO") following the UP/SP merger, shippers still lost on the order of hundreds of millions of dollars spent on increased equipment charges, substituted motor carrier service, lost orders, and other expenses resulting from the UP service meltdown. The ESO was, unfortunately, too little, too late.

Similarly, following the Conrail split-up, what would an effective remedy be for the failure of NS and CSX to increase north-south intermodal traffic, the linchpin of their strategy for increasing traffic post-merger? What is the remedy for transit times that are still – after nearly 18 months post-split -- considerably worse than Conrail delivered pre-split? There really is no effective remedy short of mandated post-merger rate caps so that captive shippers (such as the members of the Council and APC) do not have to pay the costs of a merger's failures, and mandated liability for degradation in service post-merger. Short of such across-the-board service and rate guarantees, the Council and APC view any contingent remedies to be largely illusory. Indeed, there really is no good reason that merging carriers should not provide across-the-board service and rate guarantees. Every merger applicant says that the merger will result in greater efficiency, lower costs and better service. The guarantees would be the only reliable way to ensure that the railroads' claims are not just talk.

VII. Conclusion

The Council and APC believe that the authority to approve mergers and rail marketing agreements/alliances should be statutorily transferred to the US Department of

Justice. In the absence of such a transfer of jurisdiction, the Proposed Rules should be substantially strengthened by:

- Mandating that all gateways and interchange points that existed pre-merger be kept open, either as part of the Access Condition previously proposed by the Council and APC, or through the system of market-driven proportional rates discussed above and in the accompanying verified statement of Mr. Kammerer.

- Clarifying that shippers of international traffic should have all rights regarding interchange, interswitching and competitive access that they now have under Canadian (or Mexican) law.

- Maintaining ongoing enforcement proceedings to hear any shipper complaints that gateways have been closed or commercially disadvantaged by the imposition of higher rates than existed pre-merger.

- Modifying the Board's "bottleneck" rule to require merging carriers to publish rates to/from any reasonable interchange point with another carrier, regardless of whether the shipper has obtained a contract or commitment from the connecting carrier regarding the portion of the movement beyond the interchange point.

- Expanding the scope of the Proposed Rules to encompass review of rail marketing alliances under the current DOJ/FTC Antitrust Guidelines for Collaborations Among Competitors, and setting out in detail standards for Board approval of applications under section 10706 for joint ratemaking authority.

- Addressing the issue of "acquisition premiums" by requiring the merger applicants to show how their merger transaction can be paid for without burdening shippers with higher rates or worse service.

- Clarifying that the Proposed Rules require applicants to fully preserve through conditions all actual and potential rail competition that would be reduced in the absence of the conditions.

- Requiring, in instances in which enhanced competition is offered as a means of balancing harms that cannot be directly remedied, that there is a geographic and industry balance so that the enhanced competition benefits the same areas and industries that would likely suffer the harms.

- Mandating, as part of the required contingency plan setting forth "additional measures that the Board might take if the anticipated benefits fail to materialize in a timely manner," across-the-board guarantees that rates will not increase and service will not deteriorate.

The Council and APC believe that the Proposed Rules show a movement in the right direction, but must go considerably further is they are to offer meaningful protection to shippers from the harms which have regrettably become commonplace in recent mergers.

Respectfully submitted,

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Dated and Due: November 17, 2000

CERTIFICATE OF SERVICE

This is to certify that I have, this 17th day of November 2000, caused copies of the foregoing comments to be served upon all parties of record by first class mail.

Scott N. Stone

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

VERIFIED STATEMENT OF
EDWARD G. KAMMERER

My name is Ed Kammerer. I am Vice President-Sales with OneChem Ltd., a company that builds and hosts software which enables chemical companies to conduct business over the Internet. Before joining OneChem Ltd., I was employed by the Canadian National Railroad as Vice President of Chemical Marketing. Prior to this I was employed by the Illinois Central Railroad as Vice President of Marketing and Sales. Prior to my employment by Illinois Central, I spent 10 years working for the Southern Pacific Railroad in various sales and marketing positions including VP Chemicals. In addition to my railroad experience I worked in the chemical industry for approximately 14 years for Union Carbide and Celanese. I held positions in manufacturing, operations planning and distribution.

My responsibilities at the railroads for which I worked involved various marketing responsibilities including the planning and implementation of marketing strategies as well as the establishment of key marketing alliances with connecting railroads.

Additionally I worked on teams which were involved with merger related issues concerning the SP/SF attempted merger, SP/DRGW merger, IC/CN merger and the attempted CN/BN merger. Day to day responsibilities included negotiation and implementation of rates, contracts, and joint marketing agreements.

I am providing this Verified Statement in support of the comments of the American Chemistry Council and the American Plastics Council. As I explain below, I believe that the Surface Transportation Board should adopt specific guidelines to ensure that mergers enhance, rather than reduce, shipper's choices of routes and interchanges. In addition, I believe that the Board's merger rules should encompass review of proposed marketing alliances to assess whether they have possible anticompetitive effects.

Tendency of Railroads to Limit Choice of Routes

Railroads tend to want to limit the routing options of shippers in order to maintain traffic density on their preferred routes. This strategy may enable the individual railroads to operate more efficiently, but often results in sub-optimal efficiency for the overall rail network. The result is that the shipper has fewer choices and in some cases a non-optimal total route, resulting in higher cost.

Railroads in the past sometimes physically closed connections or removed routings altogether from tariffs or circulars, but today railroads typically use pricing strategies to effectively close gateways and therefore limit shipper routing options. From single carrier served origins this is sometimes done by requiring the same gross revenue to a closer interchange point as would be obtained to the longer destination or interchange point. This effectively closes the closer interchange because the combination of the origin carrier's rate and the rate that would be charged by the connecting carrier (even allowing little or no margin) is uncompetitive. If the origin railroad were to simply require the same total margin it would have received from the longer haul (i.e., charging a lower rate in line with its lower costs on the shorter haul), this approach would on the surface make its bottom line indifferent to the route the shipper might choose. However, the originating carrier's concern is that if it charged a lower rate to the interchange, the competing carrier might be able to offer a rate from the connection that would make the combined rate competitive with the origin carrier's long-haul route, and win the joint route segment. This would decrease the origin carrier's density on the longer haul route and cause all remaining traffic on that route to be less profitable. This is something the origin railroad would very much like to avoid; hence it will typically do whatever it needs to do to preserve the longer haul. In the case of chemical and plastics shipments, where the majority of shippers do not have a rail alternative at origin, the originating carrier is usually able to preserve its long haul routing notwithstanding what the shipper might prefer if there were a choice of carriers.[1]

In some cases the origin railroad's longer route may be less efficient than the alternative joint route because of circuity, delaying factors or other issues. Nonetheless, the origin railroad often has a disincentive to share what might theoretically be greater total profits on the more efficient joint route. It generally prefers to make a lower margin on a know quantity – the higher total gross revenues on its long haul -- rather than

[1] I am informed by the American Chemistry Council that 63% of member production facilities in the United States are captive to a single railroad.

spending time bargaining with the connecting railroad in an effort to garner a higher return on a share of the joint route.

Even if the originating carrier's preferred long-haul route is more efficient from the railroad's perspective – for example, its length might be offset by lower per-car handling costs because it avoids the need to reclassify cars in multiple yards and interchanges – it may be less efficient and more costly from the shipper's point of view. If the routing increases the shipper's cycle time, car expenses are increased for those shippers (such as those in the chemical and plastics industries) who furnish their own cars. Similarly, the route favored by the railroad may be prone to congestion or result in greater inconsistency of service. These factors add to the shipper's cost, and often would not be tolerated if the shipper had a choice of carriers and routes.

The tendency of carriers to limit shippers' choices of routes is quite evident following rail mergers. Notwithstanding pledges to keep gateways open, carriers find various ways to favor their new, longer single-system routes. Connections near the former boundaries of the merged railroads are disfavored by various pricing strategies such as those discussed above. The new single-line routes hold the promise of providing better service and shorter transit times for the same money as the previous joint routes. All too often, however, the mentality of the railroad in exploiting the new single system routes is focused not on customer service and building increased business, but rather on maximizing short term profits and hence demonstrating the value of the merger to Wall Street. For this reason service and schedules are tailored to maximize the railroad's operating efficiency rather than trying to meet shippers' need for more efficient and reliable transportation that will reduce their total transportation costs.

A Proposal To Preserve Competitive Gateways

It is my strong belief that railroads would remain healthier in the long run if they focused less on long-haul revenue growth and short-term operations-driven profits and worked more closely with shippers to provide service using their efficient routes that will meet shippers' needs and lower shippers' total costs of distribution and inventory. This strategy would make the railroads more competitive and would ultimately benefit them by increasing their volume. Some efforts towards this end have been seen in the guaranteed service by the Canadian National Railroad and other roads. Ultimately, however, I am not optimistic that such innovations – or a commitment to customer service in general -- are likely to occur in the absence of rail-to-rail competition. Competition – the fear of losing the shipper's business – has an astonishing capacity to focus the minds of the railroad's marketing department on what will serve the customer and keep the business rather than simply on what will produce the greatest efficiencies from the standpoint of the railroad's operating department.

It is therefore important, in my view, that what remaining rail competition exists in this country be preserved and enhanced rather than reduced. The Surface Transportation Board has stated its intention that further mergers be required to enhance competition, but has provided few specifics about how that should occur. It has stated a requirement that "major gateways" be kept open in mergers, but it is unclear how the Board defines "major gateways" and whether employing rate-setting to disadvantage certain interchanges would be considered gateway closure. In my view, without further specifics a rule against gateway closure would be meaningless as it could easily be circumvented by the pricing strategy I have described above.

One way to ensure that gateways will be kept open following mergers is to require the origin carrier to provide rates to the closer interchange points that are in proportion (by distance) to the rate that is offered to the longer point. This formula would have to recognize the cost of terminaling and local service experienced at the origin and destination points. These local charges could be set through analysis or arbitration and published. Also any unusual cost that is experienced on any leg of the route needs to be considered.

Requiring the origin carrier to publish a rates comparable by actual mileage to the long haul rate effectively creates competition at the origin by making it possible for a connecting carrier to make at least a small margin on joint routings where the connecting carrier can offer service efficiently. By offering the shipper a competing route, the connecting carrier can force the origin carrier to price the longer haul route aggressively to keep from losing the long haul and therefore the density on its preferred route.

This mechanism arguably has an advantage over trackage rights, haulage or other means of providing physical access because the carrier cannot interfere with or penalize the competing carriers through operational means, and the mechanism does not require any special efforts to dispatch the trains of more than one carrier in the local terminal area. For this reason, I believe this solution holds some possibility of being acceptable to railroads if done correctly.

In effect this mechanism provides a competitive constraint on the rate to the closest interchange point but does so in a way that is driven by the market rather than being prescribed by the government. This approach may also be more acceptable to railroads than increasing the ability to challenge "bottleneck" rates, although a change in the merger rules to permit challenges to bottleneck rules could be adopted as a backup to my proposal. Assuming good faith implementation of my proportional rate proposal, the markets would drive rates and reward innovation, efficiency and competitiveness. If so, resort to challenging bottleneck rates should prove unnecessary.

Ideally, my proportional market-driven rate proposal would be adopted (or mandated) industry-wide. However, by imposing it as a merger condition, it would effectively become industry-wide, assuming there is at least one further Class I merger, because the next Class I merger would almost certainly trigger the rapid consolidation of the North American industry into two large systems with some smaller regional, switching and bridge carriers still remaining.

Certainly the traditional reaction of railroads to proposals to mandate more competition is that such proposals will hurt them financially by decreasing the margins on their highly rated captive traffic. I believe, however, that the injection of more competition across the board in the North American rail industry, in the form of incentives to use more efficient joint routes, would increase rail market share relative to other modes, stimulate and reward innovation and customer service, and ultimately leave the rail industry stronger than it is currently. The added competition may require the rail industry to update its ways of doing business – for example, by making greater use of computers and the Internet for marketing, planning movements, and coordinating operations with connecting carriers. (As but one example, supply chain management using the Internet often makes it possible to predict further in advance the timing of shipments needed to replenish inventory. Increasing the lead time by several days can make it possible to ship by rail rather than relying solely on last-minute motor shipments.) These trends are already ongoing, and are certainly within the reach of existing technology and software. The railroads will find, in my opinion, that they can always obtain premium rates for premium service and efficiency, and providing competitive incentives to that efficiency and quality in my opinion will benefit the rail industry in the long run.

A Caution Regarding Marketing Agreements

Having negotiated and attempted to implement several joint marketing agreements, I feel I am in a position to comment on the Board's position encouraging the use of marketing agreements as an alternative to mergers.

To date, marketing agreements have had a limited impact on the railroad landscape. In a nutshell, they have seldom been successful in achieving any broad-scale integration of operations and incentives. Typically, the agreements are motivated by efforts to compete on particular routes for particular shippers. When a railroad finds itself in a non-competitive position due to a route or other service disadvantage it will look for a solution by joining with a connecting railroad to come up with a route that will be competitive. The idea is that it is better to get something rather than nothing. The challenge is to find a connecting railroad that would not otherwise have a shot at the business and is therefor also looking at something rather than nothing.

Because it is expensive to negotiate and administer joint agreements on a route-by-route basis (the small amount of traffic being just not worth the effort), the challenge is to find solutions on a global basis and get all of the parties to look at the global benefits rather that only looking at each piece of business and whether they could handle it without the marketing agreement. The problem then becomes trying to negotiate and administer a general set of rules that will cover various types of traffic over various routes. Even if such an agreement can be negotiated, the agreement tends to fall apart because of the way each railroad will interpret the rules in different situations and try to maximize their individual benefits. Each railroad will try to use the agreement when it is to its advantage and bypass the agreement when working together is not to its advantage.

Although the Board seems to be trying to give marketing agreements a "green light," I am not sure how the railroads will respond to this invitation. Some railroad executives, notably Dick Davidson of Union Pacific and John Snow of CSX, have signaled that they intend to explore the increased use of marketing agreements. Others are skeptical. Tom Finkbiner, formerly of the Norfolk Southern and now President of Quality Distribution Services, a motor carrier, has called these alliances "illusory."

One factor limiting the use of joint marketing agreements is the legitimate fear railroads have concerning whether their joint marketing efforts will run afoul of the prohibition against joint rate-setting. Unless there is a joint rate agreement approved by the Board, the two railroads involved in the marketing agreement cannot discuss one of the most fundamental issues – how to jointly offer a rate that can win the shipper's business. Without the ability to discuss rates, it would be difficult in my opinion for joint marketing agreements to achieve much more success than they have in the past.

On the other hand, if railroads are encouraged to apply for joint rate-setting authority, and the Board were to grant such authority freely, I would be worried that the two railroads in the alliance would use their rate-setting power to do collectively what each individual railroad tends to do now – that is, set prices so as to preserve their joint long hauls and exclude competition from connecting roads. The result would be similar to what happens after a merger, but there is no indication that the Board would review applications for joint rate-setting authority with anything near the level of attention devoted to the review of mergers. This might allow railroads to obtain "through the back door" some of the same things they generally seek when they merge.

As an alternative, I would offer again my proposal for market-driven proportional rates as outlined above. If railroads are required to publish rates to interchanges that have the potential to permit competition between joint routes and the railroad's long haul, then the railroads will be forced to reconcile themselves to both competition and cooperation. They will learn to compete where they can truly be most efficient, and cooperate where a joint routing is more efficient and produces a lower rate.

Conclusion

I believe that the merger rules should be strengthened by including specific guidance on how gateways must be maintained following mergers. I offer the proportional market-driven rate proposal outlined above as a way in which gateways could effectively be kept open by enabling connecting carriers to participate in competitive joint routings when such routings are efficient. Because my proposal would create routing options, it would be one way to create competition even for traffic moving from sole-served origins.

My proposal would require railroads to learn to be more cooperative with each other in designing their operating plans and schedules, and in this sense would lead to some of the same benefits that could be obtained by inter-railroad alliances. For the reasons I have discussed, I believe this sort of competition and cooperation will ultimately strengthen the rail industry by increasing its traffic volume and encouraging innovation and efficiency.

VERIFICATION

I, Edward G. Kammerer, swear under penalty of perjury under the laws of the United States that I have read the foregoing statement and that the statement is true and correct to the best of my knowledge.

Edward G. Kammerer

Edward G. Kammerer

10/4/2000

date

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

VERIFIED STATEMENT OF
TERRY A. PARK

Introduction

My name is Terry A. Park. I am Vice-President of the Canadian Resource Shippers Corporation ("CRSC"). CRSC is a Canadian company engaged in facilitating rail to rail competition and assisting resource industries in their transportation endeavors. This submission is made on behalf of the American Chemistry Council and the American Plastics Council. I have previously provided testimony in the earlier phase of this proceedings on behalf of CRSC.[1] I have been asked to focus my comments on competitive issues surrounding the potential loss of trans-border gateways by the further streamlining of the North American rail industry.

1 See my Verified Statement on behalf of CRSC submitted May 15, 2000 in this docket.

The US Rail Network

Since the Staggers Rail Act was enacted in 1981, the number of rail carriers in the US has been reduced sharply as mergers occurred. Although the mergers have improved the finances of the railroads and permitted them to streamline their operations, this consolidation caused the closure of many routings, interchanges, and gateways that had been the cornerstone of shippers' competitive options.

This was a unique feature of the US railroad system - a network of smaller and larger railroads who combined their rail assets to create a virtual transcontinental network. Shippers using the network had many choices in selecting carriers or combinations of the same in a strategic manner in order to access their markets. Service levels were often superior to those witnessed in recent years despite the fact that usually more switching was performed in order to facilitate the movement of cars between carriers on the network.

Declining market share experienced by the railroads in the face of truck competition led to the first phase of consolidation among local rail carriers. Competition for shippers was lessened as local interchanges disappeared. The next period was one of regional consolidation whereby competing carriers in a distinct geographical area were merged. This led to the further elimination of many traditional gateways, including interchanges located on the Canadian border. Finally, consolidation began to occur on a national basis as the number of Class 1 carriers declined to 10 by the mid-nineties and has left us with four major US rail systems and two in Canada. As relatively underutilized lines were abandoned and assets were pared back so as to enable the merging railroads to harvest some benefit of the mergers, serious problems caused in part by the magnitude of the cutbacks and in part by merger implementation problems began to emerge including massive service failures and line and gateway closures.

The Canadian Experience

As the United States contemplates the possibility that North American railroads might eventually merge into only two transcontinental systems, Canadian shippers are already well aware of the difficulties caused by a transcontinental rail duopoly, as Canadian National Railway Company (CN) and Canadian Pacific Railway Company (CP) have been a duopoly in Canada for the past 80 years. In order to counterbalance those railroads' substantial market power, the Canadian government has found it necessary to legislate specific competitive access and dispute resolution mechanisms in an attempt to level the playing field for captive shippers, including traffic destined for US markets.

My previous testimony in this proceeding explained how Canadian legislation in 1988 mandated extended interswitching and competitive line rates to protect captive rail shippers in Canada.[2] One of the virtues of those remedies is that they are defined rather precisely so that obtaining relief in situations covered by the legislation is reasonably straightforward. The result is that the CN and CP usually moderate their pricing in situations where the remedies are potentially available.

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[2] See pages 3-4 of my May 15, 2000 Verified Statement on behalf of CRSC.

Given the reality that US and Canadian carriers have merged and may merge further in the future, the Surface Transportation Board should acknowledge and make clear, as part of its merger rules, that in any merger of US and Canadian carriers, the shipper remedies now available in Canada will continue to be available.

In addition, in my opinion, US shippers would need the benefit of a similar kind of predictable, objective remedy in the event further mergers resulted in a US rail duopoly. The American Chemistry Council and the American Plastics Council have outlined two such remedies, in the form of their proposed Access Condition (put forward in their comments in this docket filed May 16, 2000), and their alternative proposal for market-driven proportional rates outlined in their comments to be filed on November 17, 2000. In my view, the general pro-competitive positions outlined by the Surface Transportation Board in its Notice of Proposed Rulemaking in this docket are not sufficiently specific, or sufficiently predictable in their application, to provide reliable protection to captive shippers.

Need to Preserve International Interchanges

Despite the divergent backgrounds of Canadian and US railroads, there is little doubt that they look at lot alike today, which was emphasized by the BN- CN merger application earlier this year. Indeed it is timely that the current Surface Transportation Board review of its merger rules includes an examination of cross-border issues. That review needs to include the issue of the growing power both US and Canadian carriers have with the few remaining trans-border gateways. With NAFTA having caused an increase in north-south traffic flows, a re-examination of this area has become even more pressing.

The review of international interchanges needs to ensure that vigorous rail-to-rail competition is maintained at these gateways. Therefore keeping the gateways open and effective should be included in those transnational issues for discussion with Canadian authorities as stated by the Board.

It is in the public interest to maintain the maximum number of gateways possible, and the security and sovereignty concerns raised by some parties during the comment process should not be permitted to serve as an excuse to restrict access to or limit interchanges. Keeping gateways and interchanges open and effective should be a common goal on both sides of the Canadian-US border.

One related issue that the Surface Transportation Board should be certain to deal with in its merger rules is the continued availability of "rule 11" routings between Canada and the United States. Shippers in Canada currently have the right to specify, in a Bill of Lading, that their traffic is to be carried by the originating carrier to an interchange point, thence via another carrier beyond to destination. This is usually done by reference to AAR Accounting Rule 11 for the movement beyond the interchange point (although the existence of Rule 11 is not essential for that purpose). The Bill of Lading reference signals the originating carrier that the shipper has chosen a routing for its traffic which requires the originating carrier to interchange the traffic to a connecting carrier for furtherance to destination.

This fundamental right of Canadian shippers to choose their own routings for the movement of their goods, to choose which carrier or combination of carriers will carry those goods, and to obtain the best price for the movements in making those decisions, has been upheld in Canadian jurisprudence, and is based on the interpretation of Canadian National Transportation Policy as expressed in section 5 of the *Canadian Transportation Act.*[3]

Future mergers involving Canadian railroads could affect these rights. For instance, a CN/BNSF combination could effectively eliminate the ability of shippers to seek competitive rates in this manner at points where CN connects with BNSF, unless the Board and Canadian authorities reviewing the merger ordered as a condition to the merger that Rule 11 routings must continue to be offered. The simplest and best principle, which the Board should include in its final merger rules, is that in any future merger, shippers of international traffic between the US and Canada will continue to have all rights they enjoyed pre-merger under either Canadian or US law, or under existing railroad practices, to select gateways, routings, and connecting carriers for their international traffic.

Rail Restructuring in a North American Context

Canada offers some additional models that could be of benefit to ensure increased railroad efficiency without anticompetitive effects. For example, in Canada, CN and CP share track to increase traffic density on low density lines (in eastern Canada) and to increase capacity on high density lines (in western Canada).

[3] See Canadian Transportation Agency decision No. 457-R-1997 dated July 17, 1997; also the decision of the Canadian Federal Court of Appeal in *Canadian National Railway Company v. Eagle Forest Products Limited Partnership* dated December 13, 1999, Docket A.731-97 which dismissed CN's appeal of Canadian Transportation Agency Decision No. 457-R-1997.

This arrangement is similar to that in the western United States, where Burlington Northern Santa Fe and Union Pacific Railroad have implemented joint dispatching over shared track assets in the Gulf coast area. It also parallels the situation in the eastern US where Norfolk Southern and CSX now have mutual traffic solicitation rights in shared asset areas of the former Conrail system.

Another Canadian example of sharing rail assets is the retail operation of double stack container trains by ocean carriers, purchasing wholesale power and track capacity from the railroads. This arrangement looks a lot like the open access system that some captive shippers seek.

There is not much technical difference between trains of merged railroads operated over the same infrastructure and jointly dispatched trains of different railroads operating over jointly owned infrastructure, or sharing each other's infrastructure. But there is a big difference in the economic behavior of merged railroads as opposed to those sharing assets. Merged railroads try to capture their merger's "efficiencies," but too often this is just a code word for excluding other carriers from their merged routes.

The Surface Transportation Board has proposed that merger applicants be required to show how the benefits they plan to obtain from their merger cannot be obtained through joint marketing or operating agreements or alliances. This is probably a useful proposal, because mergers in practice have tended to be more anticompetitive than the rail alliances we have seen to date. But we need to bear in mind that marketing alliances can also pose anticompetitive dangers - witness the current litigation directed at the Northwest -

Continental alliance in the airline industry. An example of an rail "alliance" that has the potential to inhibit competition is the agreement of six railroads to route international Canadian/US traffic to destinations via a call to a 1-800 number. Although perhaps well-intentioned, this program has the effect of assisting the participating railroads to divide the traffic and coordinate pricing, thereby restricting competition.

If the Surface Transportation Board does its job right on the merger rules, both mergers and rail alliances will be subjected to sufficient scrutiny and conditions that competition will be preserved and even enhanced. What the Board should be looking for are agreements and alliances that will preserve all of the remaining large rail systems as independent competitors, while seeking to coordinate operations and, where possible, share assets, so as to achieve efficiencies while at the same time expanding shipper choices.

In short, we have many examples of increased efficiency and better service through rail cooperation short of merger. So long as the Board takes a hard look at alliances to make sure they offer benefits without restricting competition, this is the direction the Board should move in.

VERIFICATION

I, Terry A. Park, swear under penalty of perjury under the laws of the United States that I have read the foregoing statement and that the statement is true and correct to the best of my knowledge.

Terry A. Park

Terry A. Park

NOV 14/00

date